CORUMO HOLDINGS LTD. & ORS.

v.

C ITOH LTD. & ORS.

SUPREME COURT, NEW SOUTH WALES
ROGERS CJ
10 & 18 DECEMBER 1990

COMPANY LAW: *Loans to directors - Breach of prohibition - Effect on transaction - Whether rendered illegal - Applicability of law of illegality - Whether all aspects of a transaction rendered void and unenforceable - Consequences of a particular decision - Technical arguments - Intention of section - Protection of company making loan, shareholders and creditors - Whether company wronged should be subjected to civil or penal liability - Section not intended to protect those who may benefit from prohibited payments - Companies Code (NSW) [Aust], ss. 8, 9, 230.*

Company C which represented the interests of the third plaintiff WA, entered into a joint venture agreement with 2 Japanese corporations, C Itoh (CI) and Shimizu Construction Ltd. (S), for the development of certain property which was owned by the third defendant, Tisaren (T). CI's 50% interest was held beneficially by WA, CI's 25% interest was held through a subsidiary, the fourth defendant, No. 7, and the 25% interest of S was held through a subsidiary, the second defendant, SC.

The directors of T resolved to classify the units into A, B and C class units, and also resolved that the A class units would entitle the holders only to interest in stage I of the development, B class units for stage II and C class units for stage III. However, the relevant certificates for the B and C class of units were not issued or registered as the directors of CI failed to support a motion for the issuance of these certificates, this being a requirement under T's articles of association. The project was to be financed by No. 100, the fifth defendant and SA, details of which were set out in a syndicated facility agreement dated 10 March 1988.

Under a unitholders' agreement also made on 10 March 1988 between C, S, T and No. 100, it was specified that if stage II was not completed by a certain time period, C would acquire the units held by CI and S by procuring for T the necessary funds to pay the holding cost incurred by the CI and S interests. C's obligations to purchase these shares were guaranteed by BNY. Under this guarantee, the guarantor would not be liable to pay any sum demanded unless, *inter alia*, the certificates of all B and C units of trust were received on settlement.

As a result of a requirement that the Japanese companies have one resident Australian director, CI's solicitor, PS, was appointed shareholder and director of CI's Australian subsidiaries and the shares were purchased by consideration provided by CI; these shares were held by PS on trust for CI.

Stage II was not completed within the requisite period and C became liable to purchase the shares of the other joint venturers. However C argued that the syndicated facility agreement between the parties was void because CI had breached s. 230 of the Companies (NSW) Code (the Code) by providing loans to its directors. It was C's contention that therefore, certain clauses of the unitholders' agreement and the guarantee

by BNY were also void as they were related agreements. It was also submitted that the guarantee had been vitiated as a result of an alteration made to the unitholders' agreement.

C provided a highly technical interpretation of s. 230 and argued the concepts of beneficial interest, relevant interest and deemed power of disposal of shares under s. 8 of the Code and the concept of associated persons under s. 9 of the Code.

The defendants denied a breach of s. 230 of the Code, submitting that even if there was a technical violation of the section, the consequence was a penal liability and not one which rendered the joint venture and related obligations illegal or unenforceable. In relation to the validity of the guarantee, the defendants raised the defences of estoppel and waiver. The defendants seek payment of moneys payable under the agreements, over and above the principal amount lent by No. 100 and SA.

It was C's submission that the additional obligations that C assumed under the unitholders' agreement, the syndicated facility agreement, and the guarantee by the bank, are unenforceable by reason of illegality. The argument is that the guarantee itself, given by the bank, is unenforceable for the same reason.

The issue for determination was the obligation of T to issue the B and C class units. The Court also discussed the purpose of s. 230 and the persons it was intended to protect, the consequences of a breach of s. 230 and, *inter alia*, the applicability of the law of illegality and its effect on the enforceability or validity of a transaction which was carried out in breach of s. 230.

Held:

[1] The purpose of s. 230 of the Code was to protect a company, its shareholders and creditors from misapplication of the company's funds for the benefit of directors or interests associated with directors.

[2] When an issue of illegality is raised, it is necessary to determine precisely what the subject matter of the statutory proscription is. This is to enable the Court firstly, to more clearly consider the question whether that which is proscribed by the statute was intended to be illegal as distinct from merely penalised and secondly, to enable the Courts to apply with a greater degree of precision and flexibility, the consequences of the decision that, in the particular case, the law of illegality was intended to apply; if the law of illegality is applicable, it does not follow that all aspects of a transaction are void or unenforceable.

[3] It was clear that the Legislature intended that it was inappropriate to subject the company making the prohibited loan, and which was to be regarded as the wronged party, to any liability, civil or penal (see s. 230(7)). The lender was specifically given the right to recover the loan, interest on it, as well as any loss suffered under any guarantee or security provided. Furthermore, under s. 230(5), when the section has been breached, directors and officers of the wronged company are made liable to indemnify the lender company against any loss. The section does not manifest any intention to protect those who may receive the benefit of the prohibited payments, from any obligations they may have undertaken in connection with the prohibited transaction.

[4] The plaintiff's argument can only be sustained if it can be argued that the infringement of s. 230 brands all transactions related to the loan as illegal. The principals in the allegedly proscribed transaction, SA and No. 100, the lenders, are entitled to recover from the borrower T the moneys lent. However on the plaintiff's argument, they are not entitled to recover the money from a third party, the bank, whose guarantee of payment may be the only way of actually obtaining the money. Such a result would be patently absurd and contrary to what one would expect parliament's intention to have been.

[5] Section 230 devoted considerable attention and care to a definition, both civil and penal, of the consequences of a breach (see s. 230(10)). The prohibition in s. 230 is directed to transactions, that is, the making of loans to particular classes of persons and entities. The statutory protection is for the purpose of providing protection to the company making the loan and it would be scant protection if it stopped short at permitting the recovery of money lent. To strike down transactions due to illegality may absurdly result in substantial detriment to the wronged company, and allow a windfall to the other party or to a third party.

[6] Section 230 works to protect a company which pays money either directly, or indirectly, or assumes some obligation such as a guarantee, as a result of a transaction in breach of the section. The section seeks to ensure that the company is in no worse position as a result of the provision. Thus the company may recover money paid and may avoid a guarantee it had given.

[7] In this case, the companies to be protected are No. 100 and SC; the need to protect them does not require that the obligation to issue the certificates for B class units and C class units, and the obligations to honour the guarantee, be held to be struck by illegality.

[8] The results sought by the plaintiffs would work to the detriment of the company designed to be protected by the provision and would mean that the company would lose the benefit of the agreements and the guarantee provided by the bank.

[9] The bank is entitled to look to some of the plaintiffs for indemnity in respect of any money it may be obliged to pay under the guarantee.

[10] The bank is estopped from claiming that, by reason of the variation of obligations between the plaintiffs and the defendants, it is not bound by the guarantee as varied. It was the intention of the defendants and the bank that the guarantee would continue to bind the bank, to the limit stated in the guarantee, in respect of liabilities of the plaintiffs under certain clauses of the unitholders' agreement; the deletion of a clause did not signify any departure from this intention.

[11] As a result of the defendants forgoing the opportunity to call up the guarantee, the guarantee became unenforceable when the liability of the plaintiffs changed; it is therefore necessary to restore the defendants into the position they would have been in on 9 May to neutralise the detriment they suffered.

[12] In the circumstances of this case, there should be an implied term in their agreement that C would do all things necessary to be done on its part to enable and cause T to allot and issue the units and certificates relating to B and C class of units - this is a specific implementation of the obligation arising under the unitholders' agreement.

Alternatively, the resolution of 9 March 1988, coupled with the requirement under a trust deed for issue of unit certificates, requires the directors of T join in the necessary resolution.

[Judgment for the defendants with costs.]

Cases referred to:

Neugarten v. Standard Bank of South Africa Ltd. [1989] 1 SA 797 ***(cons)***
Hurst v. Vestcorp Ltd. [1988] 12 NSWLR 394; 13 CLR 17 ***(cit)***
First Chicago Australia Ltd. v. Yango Pastrol Co. Pty. Ltd. (No. 3) [1977] 2 NSWLR 583; [1978] 139 CLR 410 ***(cons)***
Yangpo Pastoral Co. Pty. Ltd. v. First Chicago [1978] 53 ALJR 1 ***(refd)***
Re Mahmoud v. Ispahani [1921] 2 KB 716 ***(cons)***
Che Wan Development Sdn. Bhd. v. Co-operative Central Bank Bhd. [1989] 2 ACSR 61 ***(not foll)***

Legislation referred to:

Companies Act 1965, s. 133
Companies Code (NSW) [UK], ss. 8, 9, 230
Companies Act 1948 [UK], ss.54,190

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For the 8th defendant - A.R. Emmett QC (P.M. Wood with him)
For the defendants (Solicitors) - Blake Dawson Waldron, Allen Allen & Hemsley

JUDGMENT

Rogers CJ:

The hearing of the separate issues in this action has become lengthy and complex, primarily because the plaintiffs' wish to avail themselves of a statutory provision in s. 230 of the Companies (NSW) Code, which was enacted to avoid corporate abuses of a kind which are totally absent here. None the less the plaintiffs contend that they have proved some highly technical breaches of the section which, in their submissions, have the necessary consequence that, what are, on their face, perfectly proper commercial transactions are made illegal and unenforceable. As well, although the bank, which at the behest of the plaintiffs' obligations to the defendants, was willing to honour its guarantee, the plaintiffs argue that it also is unenforceable. In fairness to the plaintiffs, I should mention that, by their summons, they have tendered for determination grievances that they claim they have against some of the defendants quite apart from the subject of the separate issues. The validity of those grievances has been left to another day. This has created problems of its own which will be discussed shortly. For the sake of completeness, I ought also to mention that, by their further amended first cross-claim, the defendant seek payment of an amount many times more than the claim by the plaintiffs.

It is necessary to explain only some of the underlying facts which gave rise to the disputes between the parties. Although the plaintiffs' claims relate to 2 developments, one in Queen Street and one in Exhibition Street Melbourne, which were separately documented, the issues for consideration may be sufficiently exposed by confirming my account to the Queen Street site. In its essential features, the principal transaction entered into between the parties, was simple. In March 1988, Corumo Holdings Pty. Ltd. (Corumo), which represented the interests of the third plaintiff, Mr. Warren Anderson, agreed with representatives of 2 Japanese

corporations, C Itoh & Co. Ltd. and Shimizu Construction Co. Ltd., to embark on a joint venture for the purpose of developing the Queen Street property. The registered owner of the property was the third defendant, Tisaren Holdings Pty. Ltd. (Tisaren). Tisaren held the land as trustee of the Latrobe Street Unit Trust established by deed bearing dated 20 June 1986. Under the joint venture arrangements, 50% of the beneficial interest in the trust was to be held by the Anderson interests, 25% by the C Itoh interests, through a subsidiary JC No. 7 (Australia) Pty. Ltd. (the fourth defendant, hereinafter called No. 7) and 25% by the Shimizu interests through a subsidiary S C Properties (Australia) Pty. Ltd. (the second defendant, hereinafter called SC).

The arrangement required that the trustee, Tisaren, issue 3 different classes of units, A, B and C class. For this reason, the directors of Tisaren resolved, on 9 March 1988, to classify units into A, B and C class units. The resolution provided that the A class units should entitle the holders only, but exclusively, to all the interest in stage I of the development, B class units similarly to stage II and C class units to stage III. The resolution concluded:

> Of the 12 units to which Corumo is entitled as of the date hereof, 4 shall be classified as class A units, 4 as class B units and 4 as class C units.
>
> Of the 6 units to which JC is entitled as of the date hereof, 2 shall be classified as class A units, 2 as class B units and 2 as class C units.
>
> Of the 6 units to which SC is entitled as of the date hereof, 2 shall be classified as class A units, 2 as class B units and 2 as class C units.
>
> It was further resolved that notice of the matters specified in paras. 1 and 2 above be given to unitholders in the trust.

Notwithstanding the resolution, the necessary steps to effect registration and to issue certificates to the holders of the B and C class units have not been implemented and that fact has given rise to additional complications, and to claims for relief by the defendants to the action. The explanation for the failure to issue the unit certificates is that, under the articles of association of Tisaren, the directors nominated by the 3 interests each have to vote in support of a motion to issue them. The Corumo directors, that is, the Anderson interests, failed to do so.

It may be convenient to point out at this stage also, that cl. 9 of the Latrobe Street Unit Trust required Tisaren to keep a register of unitholders and to issue unit certificates to the holders.

The whole of the funding for the development of the land was to be provided by the C Itoh and Shimizu interests making funds available to Tisaren, the trustee. Both C Itoh and Shimizu provided the funding through Australian subsidiaries other than the subsidiaries which were the equity holders in the joint venture. In the case of Shimizu the funding was provided by Shimizu Australia Pty. Ltd. (S Aust). C Itoh provided funds through JC No. 100 (Australia) Pty. Ltd., (the fifth defendant hereinafter called No. 100). The advance of moneys was regulated by the provisions of the syndicated credit facility agreement also bearing date 10 March 1988. The plaintiffs claim (summons para. C31 and 32) that on 9 March 1988 Tisaren paid No. 100 a finance advisers fees of $500,000 in contemplation of and in consideration of No. 100 entering into the syndicated credit facility agreement. As well, as required by cl. 20 of that agreement, Tisaren reimbursed to No. 100 the fees charges and expenses in connection with the negotiation and preparation of the agreement. Stamp duty came to $1,496,000, legal fees were $129,224.

The development of the property was to take place in 3 stages. Due to certain difficulties which are presently irrelevant, only stage I has been undertaken. The unitholders' agreement, bearing date 10 March 1988, made, *inter alia*, between Corumo No. 7, SC and Tisaren requires that, if stage II was not commenced by a certain point of time, Corumo acquire the units held by C Itoh and Shimizu interests. The machinery for this purpose is established by the agreement and it is unnecessary to go into all the detail of it. However, it is necessary to set out cl. 5.2 of the agreement. As amended, by a deed of variation of 4 May 1990, it provides:

> On or before 28 September 1990 Corumo or its nominee shall acquire and shall complete the acquisition:
>
> (a) from the trustee the stage II land and the stage III land at a price equal to the holding cost of such land up to the date of acquisition; or
>
> (b) if the land has not been subdivided, from JC-Shimizu the J-B units and the J-C units at a price equal to the issue price of such units.

As the facts fell out, it is cl. 5.2(b) that has become applicable. By the agreement, Corumo promised that, if the project did not develop past stage I, it would procure for Tisaren the necessary funds to pay, in accordance with the calculations set out in the agreement, the holding cost incurred by the C Itoh and Shimizu interests. This was provided by cl. 7(f) which was in the following terms:

> In respect of an acquisition of the J-B units and/or J-C units, referred to in cls. 5.2, 5.3, 6.3 and 6.4 hereof, Corumo shall procure that the trustee is in funds in an amount equal to the holding cost of the state II land (in respect of an acquisition of the J-B units) and the holding cost of the stage III land (in respect of an acquisition of the J-C units) and the trustee on receipt of such amounts shall forthwith pay such amounts to the lenders in part repayment of the financial accommodation. Any funds made available to the trustee pursuant to the requirements of this subclause shall be made available on terms and conditions that do not derogate from and are not detrimental to the rights of the lenders in respect of providing the financial accommodation.

For the purposes of the defendants' cross-claim it is appropriate to call attention to the terms of cl. 23.1 which provided:

> Each of the parties hereto shall exercise all such powers as are available to it, do all such acts and things and sign execute and deliver all such documents and instruments as may be necessary or reasonably required to give full effect to the provisions of this agreement.

As I have said, the finance for the project was to be provided by No. 100 and S Aust. The details were set out in the facility agreement, also dated 10 March 1988, and made between the 2 companies I have mentioned. Tisaren and the Anderson interests. The details of the agreement are not presently relevant.

The obligations of Corumo under cl. 5.2 and 7(f) were guaranteed up to a maximum of $32m by BNY Australia Ltd. (the bank), formerly known as Trans City Holdings Ltd. Under the unitholders' agreement cl. 3(2)(c), it was the obligation of Corumo to procure the issue of the bank guarantee. The guarantee provides that the guarantor shall be under no obligation or liability to pay any sum demanded unless on settlement it receives the documents specified in the third schedule. The documents specified in the third schedule include the unit certificates "to all B units and C units in the trust". A deed of variation to the guarantee was executed, bearing date 9 May 1990. It will be necessary later to return to the circumstances in which the deed came into existence.

Absent the argument based on the provisions of s. 230 of the Code, it does not appear to be contested that Corumo is obliged, under the unitholders' agreement, to arrange for the trustee, Tisaren, to be put in funds to make the payments to the C Itoh and Shimizu interests called for by the agreement. The argument for the plaintiffs is that the alleged breach of s. 230 has made the syndicated credit facility agreement wholly void, save to the extent necessary to give effect to s. 230(7) and (8) of the Code. In particular, cl. 20 relating to payment of fees charges and expenses is impugned. Further it is alleged that all agreement related to the syndicated credit facility agreement are void. In particular cl. 5(2), 7(f) and 17.3 of the unitholders' agreement are claimed to be void as related agreements. Recovery is sought of the finance advisory fee of $500,000 and of the fees charges and expenses paid pursuant to cl. 20 of the syndicated credit facility agreement as money had and received to the use of Tisaren. As well, the guarantee by the bank is claimed to be void, so that the obligation to repay the lenders cannot effectively be satisfied. The defendants denied that there was any breach of s. 230 in any relevant sense. Alternatively they submitted that, even if, contrary to their primary submission, there had been some technical violation of the section the consequence was a penal liability and not illegality and unenforceability of the joint venture and related obligations. As something of an afterthought, against the possibility that all their other arguments failed, at the commencement of the initial hearing, the defendants sought, and obtained, leave to amend to seek relief pursuant to the provisions of s. 539 of the Code. This aspect of the dispute was, by consent, added to the separate issues to be decided. That created problems of its own which are referred to in a judgment I delivered on 10 December.

As something of a subsidiary issue the plaintiffs attacked the enforceability of the guarantee given by the bank on a basis divorced from the Code. By the deed of variation, dated 4 May 1990, the agreement between the unitholders was changed as to the valuation of the "holding cost" payable to No. 7 and SC. The definition was amended whereby the "land value", a component of the "holding cost" was increased by some $2m. The plaintiffs submitted that, in the result, as a matter of construction, the guarantee given by the bank no longer applied to the new circumstances. Alternatively, it was said that the guarantee was vitiated by the alteration to the agreement.

During the period of the adjournment, the defendants decided that, in answer to the claim that the guarantee was unenforceable, defences of estoppel and waiver should be added to their armoury, and that all these matters should be subjected to determination as separate issues. Whilst naturally this Court is always anxious to assist in the speedy resolution of commercial disputes, the task becomes unnecessarily burdensome if parties approach the hearing of separate issues with insufficient consideration.

The final question which presently arises is as to the obligations of Tisaren to issue the B and C class units. This question has importance, because the guarantee requires the delivery up of a number of documents to the bank, does it come under an obligation to make payment.

Amongst the documents required to be delivered are unit certificates for all B and C class units in the trust.

It is appropriate now to set out some of the provisions of s. 230:

(1) A company shall not, whether directly or indirectly:

(a) make a loan to:

(i) a director of the company, a spouse of such a director, or a relative of such a director or spouse;

(ii) a director of a corporation that is related to the company, a spouse of such a director, or a relative of such a director or spouse;

(iii) a trustee of a trust under which a person referred to in subpara (i) or (ii) has a beneficial interest being a loan made to the trustee in his capacity as trustee;

(iiia) a trustee of a trust under which a corporation has a beneficial interest, where a person referred to in subpara (i) or (ii) has, or 2 or more such persons together have, a relevant interest or relevant interests in shares in the corporation the nominal value of which is not less than 10% of the nominal value of the issued share capital of the corporation, being a loan made to the trustee in his capacity as trustee; or

(iv) a corporation, where a person referred to in subpara (i) or (ii) has, or 2 or more such persons together have, a relevant interest or relevant interests in shares in the corporation the nominal value of which is not less than 10% of the nominal value of the issued share capital of the corporation;

(2) For the purpose of subsection (1), where:

(a) a company:

(i) makes a loan to a corporation, or gives a guarantee or provides security in connection with a loan made to a corporation; or

(ii) makes a loan to a trustee of a trust under which a corporation has a beneficial interest, or gives a guarantee or provides security in connection with a loan made to a trustee of a trust under which a corporation has a beneficial interest;

(b) the company has a relevant interest or relevant interests in shares in the corporation; and

(c) a person has, or 2 or more persons together have, a relevant interest or relevant interests in shares in the company,

the matters referred to in paras. (b) and (c) shall be disregarded for the purpose of determining whether the person has, or the persons together have, as the case may be, a relevant interest or relevant interests in the shares referred to in para. (b).

(3) Nothing in subsection (1) applies:

(f) to a loan made, guarantee given or security provided by a company in the ordinary course of its ordinary business where:

(i) that business includes the lending of money or the giving of guarantees or the provision of security in connection with loans made by other persons; and

(ii) the loan that is made by the company of in respect of which the company gives the guarantee or provides the security is made on ordinary commercial terms as to the rate of interest, the terms of repayment or principal and payment of interest, the security to be provided and otherwise.

(5) Where a company makes a loan, gives a guarantee or provides security in contravention of this section, the company is, notwithstanding s. 570, not guilty of an offence but:

(a) in the case of a loan made to, or a guarantee given or security provided in relation to a loan made to, a director of the company or of a corporation that is related to the company or a spouse of such a director, or a relative of such a director or spouse - the director and any officers of the company who are in default are each guilty of an offence and, in addition, are jointly and severally liable to indemnify the company against any loss arising from the making of the loan, the giving of the guarantee or the providing of the security, as the case may be;

(b) in the case of a loan made to, or a guarantee given or security provided in relation to a loan made to, a trustee of a trust referred to in subpara.(1)(a)(iii) - any director of the company, or of a corporation that is related to the company, by virtue of whose beneficial interest under the trust the making of the loan, the giving of the guarantee or the provision of the security contravened this section, and any other officers of that company who are in default, are each guilty of an offence and, in addition, are jointly and severally liable to indemnify the company against any loss arising from the making of the loan, the giving of the guarantee or the providing of the security, as the case may be; or

(c) in a case of a loan made to, or a guarantee given or security provided in relation to a loan made to, a corporation referred to in subpara.(1)(a)(iv) (in this paragraph referred to as the 'relevant corporation') - any director of the company, or of a corporation that is related to the company, by virtue of whose relevant interest or relevant interests in shares in the relevant corporation the making of the loan, the giving of the guarantee or the provision of the security contravened this section, and any other officers of that company or of the relevant corporation who are in default, are each guilty of an offence and, in addition, are jointly and severally liable to indemnify the company against any loss arising from the making of the loan the giving of the guarantee or the providing of the security, as the case may be.

Penalty:

(d) in a case to which para. (c) does not apply - $5,000; or

(e) where the offence was committed with intent to deceive or defraud the company, members or creditors of the company or creditors of any other person or for any other fraudulent purpose - $20,000 or imprisonment for 5 years, or both.

(7) Nothing in this section operates to prevent the company from recovering the amount of, or of any interest on, any loan made, or any amount for which it becomes liable under any guarantee given or in respect of any security provided, contrary to the provisions of this section.

(8) If a person has made a loan in relation to which a company has given a guarantee or provided security in contravention of this section, the person may enforce the guarantee or security against the company if, and only if:

(a) in a case where the company is a proprietary company - a certificate signed by a director and a secretary of the company certifying that the company was an exempt proprietary company was furnished to the person before the guarantee was given or the security was provided; or

(b) in any case - a certificate signed by a director and a secretary of the company certifying that the company was not prohibited by this section from giving the guarantee or providing the security was furnished to the person before the guarantee was given or the security was provided and the person did not know, and had no reason to believe, that the certificate was incorrect.

(9) A director or secretary of a company who furnishes a person with a certificate referred to in subsection (8) that is false is guilty of an offence.

Penalty: $5,000 or imprisonment for 1 year, or both.

(10) This section has effect in addition to, and not in derogation of, any other law in force in the state.

The first arm of the plaintiffs' case rested on the position held by and the involvement of Mr. Peter Stapleton, a solicitor, in both No. 7 and No. 100. In connection with the first of a number of previous and like transactions, Mr. Stapleton had advised C Itoh (Australia) Pty. Ltd., that under Australian companies legislation, it was necessary for a company to have one resident Australian director and a minimum of 2 shareholders. He informed his client that he would, if requested, hold one of the shares, in each of the Australian subsidiaries to be incorporated on behalf of C Itoh, on trust for that company. Thereafter, this practice was adopted in relation to some 26 projects prior to the transaction here in question. In each case, the procedure that was adopted was that, to the extent that finance was procured, or provided, by the C Itoh interests, that was done either by No. 1 or No. 100. These 2 companies were the only ones which provided the finance for projects where the C Itoh interests had agreed to procure or provide finance. The equity interest in every project was held by another C Itoh subsidiary. In relation to each separate venture, Mr. Stapleton made a statutory declaration, as to the terms on which he held the share in the relevant companies.

Conformably to this practice, Mr. Stapleton was a shareholder and director of No. 7. In relation to the share registered in his name, Mr. Stapleton made a statutory declaration, in which he said in part:

> The consideration for the purchase of the share was provided by C Itoh and Co. Ltd. and I acknowledge that:
>
> (a) I will deal with and vote in respect of the share, and execute such notice as, proxies and other instruments in respect of the share as C Itoh & Co. Ltd., may from time to time direct;
>
> (b) I will from time to time, as directed by C Itoh & Co. Ltd., execute instruments of transfer, whether in favour of C Itoh & Co. Ltd., or of any other person in respect of the share;
>
> (c) I will pay all dividends, accretions and other benefits received by me, in relation to holding this share, to C Itoh & Co. Ltd., or to such other party as directed by it.

Mr. Stapleton was also appointed as alternate director of Tisaren to represent the C Itoh interests.

Under cross-examination (p. 21) Mr. Stapleton said that, when the arrangements were structured in March 1988, a fellow partner in the firm of Dawson Waldron gave consideration to the question whether the arrangement could have been construed as infringing the provisions of s. 230. The answer was in the negative. Mr. Stepleton conceded that he attended a general meeting of No. 7. He obtained instructions as to whether C Itoh approved the accounts or not. No. 100 also had at least one general meeting. Mr. Stapleton attended that meeting, and took instructions from C Itoh with respect to the business of the meeting.

Arising from Mr. Stapleton's position, the plaintiffs put their case for an infringement of s. 230 on 2 alternative bases. The first argument itself had a number of alternatives. Alternatively, it was said that the loan was made by No. 100 to Stapleton, a director of No. 100 (s. 230(a)(i)), and/or the loan was made by No. 100 to Stapleton, a director of No. 7 which company was related to the lender No. 100 (s. 239(a)(ii)), and/or the loan was to a trustee of a trust, Tisaren, under which No. 7 had a beneficial interest and where a director of the lender, Stapleton, had a relevant interest in No. 7 the nominal value of which was not less than 10% of the issued share capital: s. 230(a)(iiia). By reason

of s. 8 of the Code it was said that Stapleton had a "relevant interest" in No. 7's shares in Tisaren because (s. 8(1)(d)) Stapleton had power of disposal or control over the disposal of that share. By s. 8(5) because No. 7 has, or is deemed to have, power to dispose of No. 7's 25% shareholding in Tisaren, Stapleton was to be deemed to have the same power as if he had the power to exercise, or control the exercise of the voting power attached to not less than the prescribed percentage of the voting shares in No. 7.

The second argument asserted that the loan infringed the provisions of s. 230(1)(a)(iv) because of Stapleton's interest in Tisaren. This argument tracked the deemed power of C Itoh over the shares of No. 7 in Tisaren: s. 8(8)(4). Then, the plaintiffs argued, by s. 8(8)(5), the shares in Tisaren held by the C Itoh interests, are required to be attributed to Stapleton. By s. 9 C Itoh and Stapleton are to be considered as associated persons.

Much the same submissions were made by the plaintiffs with respect to the Shimizu interests. It was submitted that Mr. Inamota held his share in SC and in S Aust in the same any as Mr. Stapleton held the shareholding on behalf of C Itoh, and that the same legal consequences should follow.

The technical arguments advanced by the plaintiffs were met by equally technical arguments propounded by the defendants. It was said that, by reason of the terms of trust, on which Mr. Stapleton held his share in No. 7, the beneficiary of the trust, C Itoh, could immediately call for its transfer. In the circumstances C Itoh had a deemed "relevant interest" in the share registered in Stapleton's name by reason of s. 8(6) of the Code. That in turn meant that by s. 8(8)(iii)(A) the "relevant interest" of Mr. Stapleton was to be disregarded for the purpose of s. 230. Alternatively, the same result followed by reason of the fact that Stapleton was a "bare trustee". There was lengthy debate as to what amounted to a "bare trustee" within the meaning of s. 8(8)(iii)(B) of the Code. Accepting that, as to one of the arguments propounded by the plaintiffs, s. 8(8)(iii)(B) provided no defence, the defendants relied on the provisions of s. 230(3)(g) as well and argued that the business of both SC and No. 100 included the business of lending money and that the loans to Tisaren were made on ordinary commercial terms in all relevant respects, in the ordinary course of business. The matters I have mentioned were but some of the refined legal propositions advanced by the parties on this aspect of the case.

Because I have come to a clear conclusion on the argument as to illegality, because of the urgency of the matter and because of the time of year, I consider it an unrewarding way of expending scarce judicial time to track the opposing arguments or examine points of law of the utmost difficulty. It is sufficient to dispose of this aspect of the matter to say that I do not accept the plaintiffs' arguments as to the consequences of an infringement of s. 230 of the Code.

The self evident purpose of s. 230 was to protect a company, its shareholders and creditors from misapplication of the company's funds for the benefit of directors or interests associated with directors. Interestingly in *Neugarten v. Standard Bank of South Africa Ltd.* [1989] 1 SA 797, the Appellate Division of the Supreme Court of South Africa, in discussing the purpose of the equivalent provision in the South African legislation, said (at 802):

> The first questions which arise are, what is the purpose of s. 226, and in whose interest was it enacted?

Goldblatt JA said:

> The clear purpose of s. 226 of the Act is to prevent directors or managers of a company acting in their own interests and against the interests of shareholders by burdening the company with obligations which are not for its benefit, but are for the benefit of another company, and/or for the benefit of its directors and/or managers.

Flemming J expressed a similar view. I respectfully agree. Subsection (2), by providing that subsection (1) shall not apply where the transactions specified are concluded 'with the consent of all the members of the company, or in terms of a special resolution relating to a specific transaction', makes it clear that the prohibition in subsection (1) **is solely for the benefit of the members of the company** (emphasis added).

If I may say so, current developments in company law in this country would suggest that creditors should be included in the category of protected persons.

The parliament was clearly of the view that it was inappropriate to subject the company making the prohibited loan, and which was to be regarded as the wronged party, to any liability civil, or penal. The section indeed went a long way (subsection (7)) to make this intention explicit. The lender was specifically given the right to recover the loan, interest on it, as well as any loss suffered under any guarantee or security provided. As a correlative obligation, by subsection (5), those in breach of the section, directors and officers of the wronged company are made liable to indemnify the lender company against any loss. There is, moreover, no intention manifested by the section, to protect those who may receive the benefit of the prohibited payments from any obligations they may have undertaken in connection with the prohibited transaction.

When the section is invoked, in circumstances such as the present, where the breach alleged is of the utmost technicality a Court is confronted with considerations which pull in different directions. The section was enacted as a clear parliamentary response to widespread corporate abuses which could not be tolerated. Because of the ingenuity of those determined to enjoy the forbidden fruit of deriving advantages from their corporate position the draftsmen cast the net as wide as imaginative drafting would permit. Clearly it would defeat parliament's intention and community expectations, as well as give a licence to inappropriate corporate activity, to read down the reach of the section. At the same time to allow the section to operate in the way propounded by the plaintiffs would be to hit an inappropriate target. Just as much detriment to the flow of proper commercial activity flows from allowing a legislative provision to apply inappropriately to a commercial transaction as does from restricting the reach of the section which, in another factual setting, may ensure that an improper transaction escapes the section. Whilst these are age old considerations, they have acquired added force at a time when, in response to blatant abuses, the parliament has acted and in casting its net wide, may have inadvertently covered persons, or situations, never envisaged, and permitted persons to take advantage of a provision never intended for their protection. Apart from such general considerations a commercial Judge must be anxious about the impact that a decision may have on the proper functioning of the commercial community. This consideration may have added significance where some of the parties come from a cultural setting accustomed to a different system of dispute resolution.

The principles which should guide the Court are not in doubt. As Mahoney JA pointed out in *Hurst v. Vestcorp Ltd.* [1988] 12 NSWLR 394 at 427; 13 ACLR 17 at 47:

> In *First Chicago Australia Ltd. v. Yango Pastoral Co. Pty. Ltd. (No. 3)* [1977] 2 NSWLR 583; [1978] 139 CLR 410, there was, in my opinion, a significant development, or at least restatement of the law of illegality as it applies to transactions. Both in the judgments of High Court and in this Court, emphasis was placed on the necessity, when an issue of illegality is raised, to determine precisely what is the subject of the statutory proscription. The reason for this is at least twofold: to enable the Court more clearly to consider the question whether that which is proscribed by the statute was intended to be, for the purposes of the law of transactions, illegal, as distinct from merely penalised; and, secondly, to enable the Courts to apply with a greater degree of precision and flexibility, the consequences of the decision that, in the particular case, the law of illegality was intended to apply. But if the law of illegality be applicable, it does not follow that all aspects of a transaction are void or unenforceable. The illegality law has often been seen to have unintended effects: in the *First Chicago* case I applied (at 595) the description 'a crude instrument of social policy apt to produce hardship'. One of the purposes of the decision in that case was to point out that, if illegality applies to what is proscribed, it does not necessarily affect transactions, or aspects of transactions, outside the proscription. Thus, as had been pointed out in *Re Mahmoud and Ispahani* [1921] 2 KB 716 at 725; *First Chicago* case (at 594); where what is proscribed is the sale of goods, a contract for the sale of goods is not within ... the law of illegality. A decision as to whether anything beyond that which is precisely proscribed is to be visited with the effects of illegality may then be determined according to the policy of the matter and the consequences of a particular decision are able to be weighed. This was pointed out by Mason J in the *Yango Pastoral Co. Pty. Ltd. v. First Chicago* case at 427-30, whether his Honour indicated that such a question is to be determined according to considerations of policy embodied in the *ex turpi* principle. With respect, his Honour's judgment indicates that the justice and good sense of the matter may be taken into account in the making of such a decision.

The same guidance is given by Kirby P (NSWLR at 412) and McHugh JA (NSWLR at 442 ff).

It is appropriate to embark on the determination of the contention before me with a restatement of precisely what it is that the plaintiffs wish to brand with the consequences of illegality. In the light of the provisions of s. 230(7), they cannot argue that No. 7 and SC are not entitled to repayment of the moneys that they have respectively lent. Nor did the plaintiffs so contend. It is useful to point out just precisely what that means on the facts of the present case. Exhibit B53 shows that the total of the principal lent by No. 100 and S Aust was $138,841,082.28. The guarantee is limited to $32m. I would have thought it is therefore clear that, unless the plaintiffs' arguments on the enforceability of the guarantee, for reasons unrelated to s. 230, are correct then to the extent of the liability under the guarantee both the plaintiffs and the bank are bound. The relevance of the argument on s. 230 is primarily due to the fact that by their amended cross-claim the defendants seek payment of moneys payable under the agreements, over and above the $138.8m. The plaintiffs submit that it is the additional obligations that Corumo assumed, under the unitholders' agreement, the syndicated credit facility agreement, and, pursuant to the giving of the guarantee by the bank, that are unenforceable by reason of illegality. As well, they contend that the guarantee itself, given by the bank is unenforceable for the same reason. It is only if it can be argued that the infringement of s. 230 brands with the consequences of illegality, all transactions which are related to

the loan that the argument for the plaintiffs can be sustained. It can be sustained. It can be seen at once how very odd is the result sought to be achieved by the plaintiffs. Of the principals to the allegedly proscribed transaction, S Aust and No. 100, the lenders, are entitled to recover from the borrower, Tisaren, the moneys lent and interest on it. However, on the plaintiffs' argument they are not entitled to recover the moneys from a third party, the bank, whose guarantee of payment may be the only way of actually obtaining the money. Such a result would be patently absurd and contrary to what one would expect parliament's intention to have been.

It is appropriate to mention one matter at once only to discard it. As can be seen, s. 230 devoted considerable attention and care to a definition, both civil and penal, of the consequences of breach. Absent subsection (10) it might have been open to argue that it was the clearly expressed intention of parliament that no consequences beyond those specifically prescribed, should flow from a contravention of the section. However subsection (10) in terms works to deny that proposition.

The question of statutory interpretation in this case is more than usually difficult. It is not simply a question of determining whether the Legislature intended to vitiate a contract made in breach of the provisions on the legislation. Self evidently, the parliament had in mind that some aspect of the contract may not be enforceable because it made specific provision for enforceability of some guarantees as well as for the repayment of loans. Did those provisions mark out the boundaries wherein transactions may be enforced, notwithstanding an infringement of the legislative prohibition against loans of money? Or alternatively, did the parliament merely identify some common and prominent areas in relation to which it made clear its concern to protect the rights of the lender company, and left the rest of the task to the application of the usual rules? As in all other instances of statutory construction, the task of the Court is to give effect to the parliamentary purpose. The parliamentary purpose has to be divined from the words used by the parliament.

The present case, of course, is completely unlike the legislation under consideration in *Yango*. Hence, the prohibition is not against a course of conduct, that is, carrying on the business of banking. It is directed to transactions, that is, the making of loans to particular classes of persons and entities. None the less, the statutory provision is for the purpose of providing protection to the company making the loan. It would be scant protection indeed, if it stopped short at permitting the recovery of money lent. All sorts of collateral advantages may be conferred, which would be made unavailable to the lender by reason of the restriction on the scope of the striking down of the transaction due to illegality. So to do would be to allow substantial detriment to be inflicted on the wronged company, and allow a windfall, for no good reason, to the other party or to a third party. Let it be assumed that instead of a falling real estate market one was placed in a rapidly rising market. A lender who, under the loan agreement, was entitled to both repayment of principal with interest and a share in the profits of the venture would receive only the principal and interest. The share of the profits would fall into the lap of the borrower as a complete windfall. One may ask how that would advance the evident intention of parliament. The result would be absurd.

The plaintiffs commence with the principle, many times stated, and succinctly expressed by Jacobs J in *Yango* (at 430):

> When a statute expressly prohibits the making of a particular contract, a contract made in breach of the prohibition will be illegal, void and unenforceable, unless the statute otherwise provides either expressly or by implication from its language. Where a statute makes it an

offence to make a particular contract, or to make it in defined circumstances, that will be construed as an implied prohibition of the making of the contract unless the statutory provision is merely in aid of the revenue.

Here the statute provided in terms as to the extent to which the contract made in violation of the statute is to be enforceable. Is that the outer limits of enforceability?

The plaintiffs call in aid the only decision on the section. In *Che Wan Development Sdn. Bhd. v. Co-operative Central Bank Bhd.* [1989] 2 ACSR 61, NH Chan J, a Judge of the High Court of Malaysia, held that a third party charge, created in favour of a lender to secure an illegal loan made by the lender to the director of the plaintiff, was illegal, and therefore void and unenforceable, by reason of the provisions of s. 133 of the Companies Act 1965 (Malaysia). With great respect to the Judge, such a result, in my view, works to defeat what I regard as the purpose of parliament. The Malaysian Act is partly reproduced in the report (at 68 and 69). Subsection (1) simply prohibits a company from making a loan to a director or, giving a guarantee or providing any security in connection with a loan made to such a director. Subsection (4) makes the making of such a loan an offense. Subsection (5) is similar in its verbiage to subsection (7) of our Act. The facts were that a director of the defendant cooperative society took a loan from it. The loan was secured by a charge on the plaintiff company's land in favour of the defendant cooperative society. The plaintiff sought and obtained a declaration that the charge was void and unenforceable. In other words, whilst the effect of the Judge's decision was that the lender could look to the director for recovery of the moneys it lent, the only security that it had to make its loan recoverable was unenforceable. If I may so, with all proper respect, at first blush, I find it difficult to see how such a result could further the purpose of the legislation.

In coming to his conclusion, Chan J made an examination of the principles of s. 54 of the English legislation, dealing with financial assistance for the purchase of a company's shares, and s. 190 relating to loans to directors. He then considered ss. 67 and 125 of the Australian legislation and the decisions given on these provisions.

The learned Judge recognised that the relevant provisions of the 3 Acts were passed to protect companies from having their assets depleted by misuse, and not simply to protect creditors and shareholders. He concluded that "the charge transaction in the present case is made illegal, and therefore void, by virtue of s. 133 of the Act, which was enacted for the protection of companies from having their assets depleted through misuse". At the risk of labouring the point, I would suggest that it hardly protects a company from having its assets misused to disable it from recovering its money by enforcing the guarantee it had obtained.

In the present case, there is no question of the assets of any company being depleted through misuse.

Section 230 works to protect a company which pays money either, directly, or indirectly, or assumes some obligation such as a guarantee as a result of a transaction in breach of the section. The section seeks to ensure that the company is in no worse position as a result of the provisions. Thus the company may recover money paid and may avoid a guarantee it had given. In the present case the companies to be protected are No. 100 and SC. The need to protect No. 100 and SC does not require that the obligation to issue the certificates for B class units and C class units and the obligation to honour the guarantee be held to be struck by illegality. Nor does it require me to uphold the other claimed consequences sought by the plaintiffs.

To return to the question posed by Mahoney JA, it is necessary once again to point out that the results sought by the plaintiffs would be to work to the detriment of the company designed to be protected by the provision. It would mean that, the company would lose the benefit of the agreements and the guarantee provided by the bank.

This conclusion makes it unnecessary that I consider the defendants' application for relief based on s. 539 of the Code. This is just as well in one sense, because a very real difficulty arose in the course of hearing. As I have said, I adjourned the initial hearing to permit the parties to prepare evidence and argument on this aspect. On the resumed hearing, the plaintiffs sought to lead evidence from Mr. Warren Anderson as to the alleged improper conduct of the defendants, not only in relation to the joint venture, the subject of these proceedings, but also in relation to other joint ventures in which they had been engaged. They argued that this evidence was admissible on 2 bases. They argued that s. 539 required the Court to undertake a 2 stage exercise. First, should it exercise its discretion to relieve at all, secondly, was relief unavailable to the applicant defendants because to grant it would cause "substantial injustice". It was claimed that the evidence bore on both aspects. For the reasons I gave I rejected the evidence. For the same reasons I gave for declining to embark on a determination of the question whether there had been a technical breach of s. 230 I shall refrain from examining the issue whether, as a matter of law, s. 539 would be available to the defendants as the basis for grant of relief.

The plaintiffs next submitted that, quite apart from the provisions of s. 230 of the Code, the bank was not liable to make payment under its guarantee. The defendants submitted that the bank not having made that claim, Corumo, which was not a party to the guarantee, did not have standing to make the submission. I am not prepared to accept this submission. The bank is entitled to look to some of the plaintiffs for indemnity in respect of any money it may be obliged to pay under the guarantee. In any event, after the plaintiffs made this submission, no doubt for its own protection, the bank amended its own defence and claimed that the guarantee was not binding on it.

It was common ground between the parties that the effect of cl. 5.2 was varied beyond simply extending the time by which Corumo was obliged to acquire stages II and III. By reason of the alteration to the definition of "land value" in the unitholders' agreement, the price to be paid pursuant to cl. 5(2), and the amount of the funds to be made available pursuant to cl. 7(f), were altered. By the same token, this had no practical impact of any kind on the obligation of the bank. Had the alteration not been made, the obligation of the plaintiffs under cl. 5.2 still exceeded $32m. It came to $35.8m.

The deed of variation of the unitholders' agreement added a new cl. 5.2A, whereby Corumo agreed to acquire from Tisaren the stages II and III land if Zarula Investments failed to pay JC No. 4 Australia Pty. Ltd., on 2 July 1990 the amount of $564,826. The further amended summons, which was filed after the conclusion of the argument, seeks a declaration that, the guarantee does not require the bank to guarantee any payment to be made, by Corumo, imposed by cl. 5.2A "which is the obligation of which JC No. 7 and SC Properties have demanded (*sic*) performed by Corumo". I have no recollection of this question having been argued, and, as at present advised, do not propose to deal with it.

The deed of variation prepared by the solicitors for the defendants initially included cl. 8 which was in the following terms:

Ratification and confirmation of amendments to transaction documents

TCH ratifies and confirms the amendments to the transaction documents in each case made by deed dated 4 May 1990.

On 9 May 1990 that clause was struck out at the insistence of Mr. Kelly, the in-house legal Counsel of the bank, and the deed of variation of guarantee extending the time for its operation was executed. Mr. Kelly made it clear to Mr. Ahern, a solicitor employed by Blake Dawson Waldron, solicitors for the defendants, that the only reason why he wanted it struck out was that he did not wish the bank to assume any greater liability than was the case under the existing documentation: Tp 145. On this basis Mr. Stapleton, under whose direction Mr. Ahern was working, decided to agree to the deletion of the clause. The documentation was required to be executed that day, in order to allow for the extensions of time of obligations desired by all parties. The only other alternative the defendants had would have been to call on the guarantee which was due to expire that day.

On the basis of Mr. Kelly's evidence, I am satisfied that the bank is estopped from claiming that, by reason of the variation of obligations between the plaintiffs and the defendants, it is not bound by the guarantee as varied. The defendants and the bank proceeded on the common assumption that the guarantee would continue to bind the bank, to the limit stated in the guarantee, in respect of liabilities of the plaintiffs under cls. 5 and 7(f) of the unitholders' agreement. The deletion of cl. 8 did not signify any departure from this intention: Kelly Tp 147. Both Mr. Emmett and Mr. Finkelstein asserted that Mr. Kelly did not know of the belief that Mr. Ahern was labouring under, that the guarantee as extended in time, would be enforceable. That is simply incorrect in the light of Mr. Kelly's evidence: Tp 148. It was by reason of this common assumption that the defendants refrained, on 9 May, from calling on the guarantee. It was at one point suggested by the plaintiffs that the guarantee could not have been called up with any effect because the defendants did not have the B and C class unit certificates. I accept the defendants' answer that the plaintiffs were sufficiently anxious at that time to obtain an extension of time, that they could have been expected to cooperate in the issue of the necessary certificates.

Mr. Finkelstein next submitted that an estoppel against a claim that the guarantee was not binding on the bank went far beyond anything required to cure the detriment suffered. I am unable to accept that. The detriment was that the enforceable guarantee was not called up on 9 May. As a result of the defendants forgoing that opportunity, the guarantee became unenforceable when the liability of the plaintiffs changed. It is necessary to restore the defendants into the position they would have been in on 9 May to neutralise the detriment they suffered.

The defendants submitted, *inter alia*, that Corumo was, in any event, estopped from putting the submission that the guarantee was rendered unenforceable. The deed of variation of the unitholders' agreement expressly provided that Corumo was to procure the continuation of the guarantee until 10 November. As the defendants correctly pointed out, this obligation would have been meaningless, unless it applied to cl. 5 as varied.

I turn then to the defendants' cross-claim for the issue of the unit certificates. Corumo had agreed to procure for No. 7 and SC the benefit of the bank guarantee to secure performance of Corumo's obligations under cls. 5.2 and 7(f) of the unitholders' agreement. Corumo must be taken to have intended that the guarantee be an effective security. The effectiveness of

the guarantee depended, in part, on performance by Tisaren of its obligation to issue the relevant unit certificates. In those circumstances, the defendants submit, and I accept, that there should be implied a term in their agreement that Corumo would do all things necessary to be done on its part to enable and cause Tisaren to allot and issue the units and certificates relating to the units. That after all is nothing more than a specific implementation of the obligation arising under cl. 23.1 of the unitholders' agreement.

Alternatively, the resolution of 9 March 1988, *supra*, coupled with the requirement under the trust deed for issue of unit certificates, *supra*, requires the directors of Tisaren to join in the necessary resolution.

The defendants should bring in short minutes to give effect to my reasons for judgment. Subject to anything the plaintiffs may wish to put, I propose to order the plaintiffs to pay the costs of all defendants to date.

Also found at [1991] 3 CLJ 2033